

Traidcraft's Response to BEIS Green Paper: Corporate Governance Reform

This response is being submitted on behalf of Traidcraft following extensive consultation with our overseas suppliers, civil society groups, previous staff representatives to the board and board members.

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Traidcraft

- Medium business (50 to 250 staff)
- Other – registered International Development charity.

Traidcraft is one of the UK's leading fair trade organisations. Our mission is to fight poverty through trade, practising and promoting approaches to trade that help poor people in developing countries transform their lives. Traidcraft was established in 1979 and comprises two operational organisations: the trading company Traidcraft plc and Traidcraft Exchange, an international development charity.

Traidcraft plc sells more than 700 food, household, soft furnishings and clothing products from nearly 100 producer groups based in 30 countries in Africa, Asia and Latin America. It had a turnover of £11.3 million in 2015/16. Traidcraft Exchange is an international development charity, with a charitable expenditure of £2.5 million in 2015/16, whose work spans capacity building amongst producers in developing countries, promoting market access for small producers (including into the UK market), policy development and advocacy. Through its policy work, Traidcraft Exchange seeks to influence government policy and business practice in the North and the South to the benefit of the poor in the developing world.

We are concerned about global and local inequality. Traidcraft Plc seeks to run as a model business, and for this reason we operate a maximum pay ratio of 1:6 between the full time equivalent salary of lowest paid staff member to highest paid staff member (Chief Executive), compile accounts of our social impacts on stakeholders, and have an elected employee representative on the board.

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Introduction

Traidcraft welcomes the Prime Minister's desire to improve business practices, so that UK businesses play positive role in society. We welcome her speech at World Economic Forum on 19 January 2017, stating:

“Businesses large and small are the backbone of our economies, and enterprise is the engine of our prosperity. But we must heed the underlying feeling that there are some companies, particularly those with a global reach, who are playing by a different set of rules to ordinary, working people. So it is essential for business to demonstrate leadership. To show that, in this globalised world, everyone is playing by the same rules, and that the benefits of economic success are there for all our citizens. This work is absolutely crucial if we are to maintain public consent for a globalised economy and the businesses that operate within it. It means businesses paying their fair share of tax, recognising their obligations and duties to their employees and supply chains, and trading in the right way; companies genuinely investing in – and becoming part of – the communities and nations in which they operate, and abiding by the responsibilities that implies; and all of us taking steps towards addressing executive pay and accountability to shareholders.”¹

Traidcraft's submission will highlight that there are significant gaps in the legal framework shaping business practices, and that these need to be addressed. The consultation asks questions about how stakeholder views are incorporated into senior decision making. However if there is no legal obligation for directors to *act* on stakeholder perspectives – the usefulness of these wider views is undermined. Executive pay should reflect performance in fulfilling the wider director's duties.

¹ <https://www.gov.uk/government/speeches/davos-2017-prime-ministers-speech-to-the-world-economic-forum>

Summary – and Structure of this submission to Green Paper Questions

Traidcraft has structured its answer in the following order:

A) Response to Qu 14 The legal framework for shaping business practices isn't fit for purpose and has significant gaps in both director's duties and in the corporate criminal liability regime.

UK companies have important impacts on the environment, other businesses, and different groups of people (consumers, employees, retired staff, workers and farmers in their supply chains, as well as communities close to their business operations). However the wider framework for shaping business practices isn't fit for purpose and there are gaps in both director's duties and corporate criminal liability regime. Addressing these gaps in law is vital. There needs to be a requirement for directors (the legal decision makers of a company) to *act* in the interests of the company, and *not to harm* stakeholders, and the primacy of shareholders needs to be tempered. On this basis Traidcraft proposes that director's duties are revised. The current directors' duties are unenforceable. Along with the revision of director's duties, the process by which directors are sanctioned also needs to be reviewed, including the rules for disqualification.

B) Responses to Q7-9 relating to Strengthening the perspective of stakeholders influencing decision making at board level.

The provision of stakeholder perspectives into board level decisions is useful. Traidcraft has had an elected employee representative on its board for more than 15 years. We recommend that all companies with more than 250 staff are mandated to include on their board an elected staff representative.

Traidcraft's compiles social accounts annually to understand the perspective of its key stakeholders. This is useful, both for Traidcraft's governance, and managers. To guard against "mission-drift" and enable the most senior part of Traidcraft's Governance structure to hear stakeholders' perspectives, Traidcraft conducts a Social Accounts process. Based on this experience we welcome the increased requirements on companies to report on key risks in relation to stakeholders, human rights, bribery and diversity. Any mechanisms, such as an advisory group, which is designed to bring stakeholders' perspectives to the Board, need to be channelled through a non-executive director.

The possibly for a director to act upon information provided by stakeholders is undermined by the current formulation of director's duties, which gives complete primacy to shareholders' considerations.

Traidcraft recommends that director's duties are amended so that directors have to act in the interests of the company, and thereby take into consideration good relationships with stakeholders. A change in director's duties will then drive more meaningful consultation.

C) Responses to Q1-6. Traidcraft considers *what performance by directors should be assessed for determining Executive pay, and how pay is set.*

Executive pay should be aligned with how they have fulfilled their director's duties. Ongoing payments from Long Term Incentive Plans should be reviewed if it becomes clear that a company broke the law whilst the executive was in post. Government will need to intervene to bring excessive Executive pay down to enable those assets to be used more wisely. Traidcraft welcomes the government's proposal to require disclosure of salary ratios. We would favour disclosure of the maximum to *minimum* salary ratio of a business. (We make proposals as to which workers should be included when assessing whose minimum pay to include.) Traidcraft would also like to propose that an external (to the board) approval process should be triggered in advance of either when an executives' pay might exceed a certain ratio above the lowest paid worker's pay; or when a proposed maximum threshold of pay might be surpassed.

D) Responses to Q10-13 Corporate Governance of Private companies

Private companies can cause serious harm to the economy, the environment and wider stakeholders. To deter poor performance in the future, it is necessary to update director's duties so that there is an explicit requirement to promote the success of the company, adhere to standards of good business conduct, and balance the interests of stakeholders more equitably with the owner/shareholder. The lack of enforcement of director's duties particularly needs to be improved, when considering enforcement of director's duties by private companies. Traidcraft would welcome the threshold for non-financial reporting to be based on characteristics of a company, not its legal form. A key trigger for improved non-financial reporting should be if a company has operations outside of the UK. Stakeholders overseas need private companies to disclose information about themselves and the standards they desire to operate to.

A) The legal framework shaping business practices isn't fit for purpose and has some significant gaps in both director's duties and corporate criminal liability regime.

Q14. Is the current corporate governance framework in the UK providing the right combination of high standards and low burdens? Apart from the issues addressed specifically in this Green Paper can you suggest any other improvements to the framework?

A) 1. The framework guiding business behaviour is made up of responsibilities set out in the Companies Act, and issue-focused laws which sanction a company for Health and Safety, Environmental, employment breaches, manslaughter and other offences. Gaps in the law mean that stakeholders are not able to hold the companies which cause them severe harms, such as injuries and deaths, to account. In most jurisdictions in the world, if these harms had been caused by an individual person they would be considered a crime.

A) 2. Director's duties, as set out in the Companies Act, do not provide an adequate framework to protect stakeholders from harm

The duties² require company directors to act in the interests of their "members"³. Members are shareholders. Directors are also asked to "have regard to" a number of stakeholders (employees, customers, suppliers, community, environment) as well as consider long term effects, and high standards of business conduct. The interests of the company and other stakeholders are at best secondary, to shareholders. There is no requirement on the directors to avoid causing or being complicit in harmful impacts upon stakeholders. Whilst these duties relating to stakeholders have enabled some brave non-executive directors to ask questions relating to stakeholder relations at board meetings, there is rarely action.

² Director's Duties are set out in Section 172 of the Companies Act 2006

(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to —

(a) the likely consequences of any decision in the long term,
(b) the interests of the company's employees,
(c) the need to foster the company's business relationships with suppliers, customers and others,
(d) the impact of the company's operations on the community and the environment,
(e) the desirability of the company maintaining a reputation for high standards of business conduct, and
(f) the need to act fairly as between members of the company.

³ Submission by David Chivers QC (CGV0103) to BEIS select committee 26 October 2016
<http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/business-energy-and-industrial-strategy-committee/corporate-governance/written/41945.html>

The Grocery Code Adjudicator's investigation into Tesco for delayed payments to suppliers found clear evidence that financial targets prioritising shareholders' interests were prioritised over relationships with suppliers. "25.2 The evidence I received revealed a number of examples of Tesco deliberately deferring payment of money in order to maintain its margin at key financial reporting periods".⁴

A) 3. Examples where wider stakeholder relationships have not been prioritised.

The following examples highlight that company directors are not considering stakeholder perspectives. These examples include instances where stakeholders have suffered very significant harms, and where a large number of stakeholders have suffered harms.

a) Section 172 (1) (c)² "have regard to the need to foster the company's business relationships with suppliers"

Retailers do not transform the products they sell. They are entirely dependent on their suppliers to make the products which they then re-sell onto their consumers. The directors in this sector might chose to pay particular attention to suppliers, but it appears that some of the UK's major retailers choose not to have regard for their suppliers.

A positive implementation of this director's duty might lead to a mutually beneficial approach. For example a Bangladeshi supplier finds it particularly helpful that H&M makes a commitment to order at least 500-600 pieces/month for the next three years⁵. Van Heusen & other US companies also make forward commitments. These forward commitments are extremely helpful for the supplier's productivity, and for planning their production schedule.

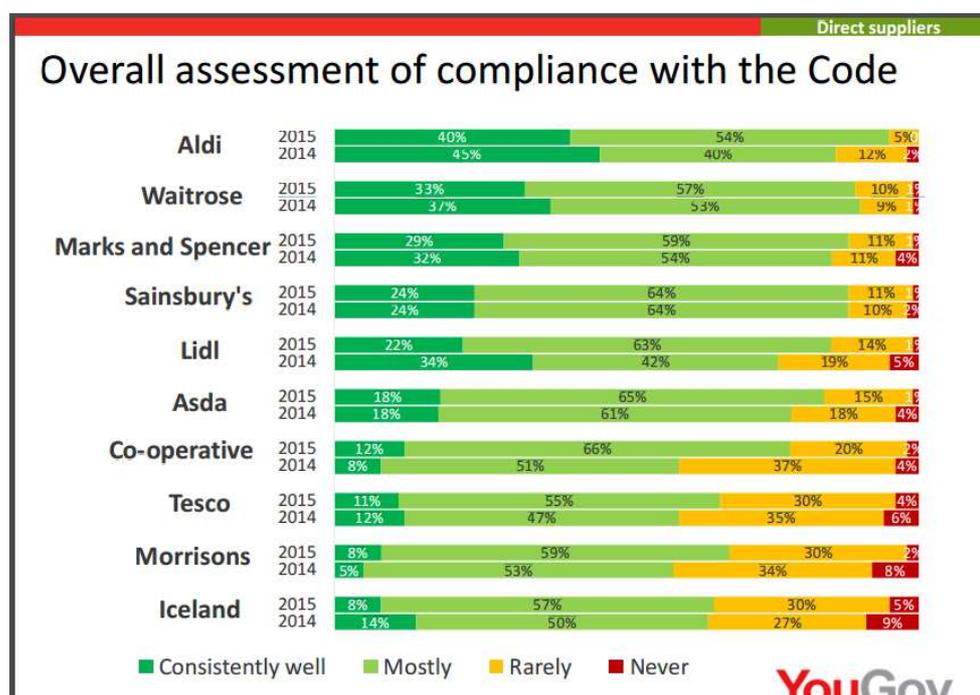
The Competition Commission's 2008 investigation highlighted that the UK's 10 largest food retailers "transfer excessive risk and unexpected costs onto their suppliers." This should be enough to alert the non-executive directors of food retailers as to the possibility of poor quality relationships with their suppliers.

Food retailer Tesco was one of the three worst performing retailers in the Grocery Code Adjudicator's supplier survey in June 2014. Only 59% of suppliers considered Tesco "Mostly" or "consistently well" complied with the

⁴ p26 Groceries Code Adjudicator 26 January 2016 "Investigation into Tesco plc" Paragraph 25. Tesco focus on meeting financial targets – deferral of payments

⁵ "PAINS & GAINS Report on the progress made, impediments and what lays ahead" Feb 2017 Authored by Mahmood Hussain & Wamiq Umaira with support from BGMEA, Bangladesh University and Narayan Das

legal Groceries Supply Code of Practice (GSCOP)⁶. The results of the supplier survey are in the public domain.



In September 2014 Tesco's £326 million accounting scandal was reported in the press. The retailer had overstated its profits, when in fact significant sums of money were in dispute with their suppliers.

On 5 Jan 2015 the Grocery Code Adjudicator (GCA) launched an investigation into Tesco relating to breach of the fair purchasing code – GSCOP. On 26 January 2016 the GCA found that Tesco had been guilty of breaching the code in relation to delayed payments to suppliers⁷. Payments were delayed sometimes for more than two years, and the value of payments in dispute could be more than £1 million. GCA's conclusion was that *"Delay in payments was a widespread issue that affected a broad range of Tesco suppliers on a significant scale. The delay in payments had a financial impact on suppliers, was an administrative burden to resolve, detracted from the time available to develop customer-focussed business and had a detrimental impact on some suppliers' relationships with Tesco."*

The scale and severity of harm to suppliers is clear from the GCA's conclusion. Despite the abusive of treatment of suppliers being a well-known problem in 2008, it appears that the directors of Tesco did not between 2008

⁶ YouGov presentation at 22 June 2015 GCA Annual Conference
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/437148/2_._Final_-_Stephan_Shakespeare.pdf

⁷ <https://www.gov.uk/government/publications/gca-investigation-into-tesco-plc>

to 2014 act on their duty to “have regard to suppliers” and work to improve relationships.

b) S172 (1) (d)² “Have regard to the impact of the company's operations on the community”

In 2009 and 2011 members of the local community were shot in Tanzania by security providers who had a contract with the subsidiary of a FTSE listed company, Acacia mining. Acacia mining was previously called African Barrick Gold and it operates a mine in northern part of Tanzania. People were badly injured and others were killed. These severe harms were brought to the attention of UK management of Acacia when a civil court case started in the UK in 2013.

Subsequently there have been further injuries caused by beatings in October 2013⁸, and shootings with live ammunition in 2014 by security providers who continue to have a contract with Acacia mining's subsidiary⁹. The CEO was questioned at Acacia mining's February 2015 results briefing¹⁰ about a worsening of relations with the local community in 2014. The reply failed to acknowledge very severe human rights violations associated with the company's operations.

The directors of Acacia mining will have become aware of severe harms caused to individuals when the UK court proceedings started in 2013, if they were not already aware of these problems. Subsequently it appears that the company failed to performance manage the security provider to ensure an end to injuries in 2014. In this instance it appears that the directors did not “have regard to” the impact of Acacia's operations on the community.

The example of Acacia mining is just one example of 24 allegations investigated by Traidcraft. The 24 allegations of very severe harms involve 18 companies: 2 private and 16 LSE listed. The companies identified include

⁸ Testimony provided at UN Forum on Business and Human Rights in November 2016 and <https://www.business-humanrights.org/en/tanzania-video-claims-local-paralysed-after-police-beating-at-acacia-subsidiarys-mine-company-denies-allegations>

⁹ UN Forum 2015 and Evans Sichelwe, Legal and Human Rights Centre (Tanzania) – minute 42 onwards <http://webtv.un.org/meetings-events/human-rights-council/forum-on-business-and-human-rights/watch/operational-level-grievance-mechanisms-forum-on-business-and-human-rights-2014/3947951226001>

¹⁰ February 2015 Acacia Briefing: Journalist question “*did things get worse in 2014?*” Chief Executive, Acacia Mining “*On the contrary, I'm not sure what incidents you're referring to, but our relationship with the community in North Mara has never been better. We're delivering on our commitments to community projects and our relationship with leaders of the community has improved. We have regular sports events and cultural events that we host. It's a very different mood as we moved around the North Mara community than what it was a couple of years ago. If you ask any member of community today or national or regional government, they would agree the relationship has dramatically improved from where it was in the past.*”

Glencore, BHP Billiton and Shell. The research mirrors broader research carried out by the Business and Human Rights Resource Centre¹¹, which identified over 300 cases where UK firms have been accused of malpractice abroad, 95% of which took place in developing countries. There have been zero prosecutions in the UK. Some of the 300 instances are caused by the same companies across several of their operations. It can be concluded that some UK companies are routinely failing to fulfil their duty "to have regard to" the impact of the company's operations on the community.

A) 4. Director's duties are currently un-enforceable

a. Directors are required to report on their non-financial performance in the "Strategic report" in the Annual Report and Accounts submitted to shareholders. This is a suitable place for a company to explain how director's duties have been exercised. However, in practice there has been no enforcement of inadequate or misleading reporting by companies in relation to how directors have exercised their duties set out in S172 (1). (a)- (e)².

b. Director's duties can theoretically be enforced by shareholders or the relevant government department BEIS. However, outside of a winding up, BEIS has never sanctioned a director for breach of their director's duties. Shareholders would often rather divest themselves of shares, than destabilise a share price by calling into question the performance of a director. For private companies where the owner and the executive can be one and the same, this lack of enforcement is particularly problematic – See Section D) 8 below.

c. The result is there is no enforcement of the current director's duties.

¹¹ <http://business-humanrights.org/en/is-the-uk-living-up-to-its-business-human-rights-commitments>

A) 5. Recommendations for improving corporate governance framework

a) Director's duties should be revised to prioritise the success of the company. In order to deliver the Government's intention to include stakeholder considerations at a board level, the government should consider rewording Section 172 of the Companies Act 2006 as follows:

- (1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company, and in doing so-
- i. have regard to the likely consequences of any decision in the long term,
 - ii. have regard to the interests of the company's members
 - iii. act to mitigate serious adverse impacts on employees, suppliers, customers, the community and the environment,
 - iv. maintain a reputation for high standards of business conduct

The effect of the main clause (1) would be to promote the longer term interests of the company, over the short term interests of shareholders. The interests of members (shareholders) are just one of the factors to which the directors have regard. The effect of (iii) and (iv) would be to create a positive obligation on directors to take reasonable steps to prevent serious adverse impacts and to maintain a good corporate reputation, rather than merely 'having regard' to these factors in the promotion of the success of the company.

b) Review how directors are disqualified. Directors need to be subject to a personal consequence for breach of director's duties or serious misconduct. In particular directors should be disqualified for failing to implement their duties, or when their company is implicated in criminal acts (pollution, serious health and safety harms, injuries, modern slavery, bribery, financial crime and deaths). The lack of enforcement is particularly acutely felt when private companies fail to respect wider stakeholders of a company. See section D) 8 below

c) The UK should avoid having directors of companies who have had criminal prosecution against them (by a UK prosecuting body, or a credible overseas prosecution body), or are on an international police extradition or watch list (for war crimes, or breaching international sanctions, etc.). These individuals are not fit and proper persons to be a director of a company. To implement this proposed policy objective Companies House, and the listings authorities (AIM and FTSE) should review the directors' names when a new company registers and review any change in the directors when companies file their annual return. UK Prosecution bodies and police, as well as UK Central Authority need to provide a list of individuals who are not suitable to be directors of companies. Individuals are more easily able to evade prosecution, when their actions are operationalised through a company structure.

A) 6. Criminal law for prosecuting companies is not fit for purpose, and in fact undermines the duties which company directors should "have regard to"¹².

- With one exception, the UK's corporate criminal liability regime is based on the identification principle. The prosecution has to identify *who* (i.e. which director) had the controlling mind in relation to knowing specific information associated with the crime caused by the company.
- For this reason main board directors may never receive in written format any briefing about contentious issues happening in their overseas supply chains or operations. Corporate prosecutions based on the identification principle are not fit for purpose for large complex corporate structures and deter sound corporate governance.
- Companies are unlikely to display "criminal intent", but decisions designed to benefit shareholders, maximise profit, yield dividends and increase share price may lead to serious harms, which would constitute a corporate crime.
- The current inadequate legal framework results in companies not being properly held to account for causing pollution, severe health and safety harms, injuries and deaths, particularly through their overseas operations.

A) 7. We recommend that Corporate Criminal liability is reviewed so that companies can be prosecuted for significant harms caused to stakeholders¹² as follows:

- a. In cases where there is bodily harm, new legislation would be needed. It is currently not possible to prosecute a company for these crimes, even in the UK, unless it can be shown that a particular senior manager or director within the company was 'identified' as directly responsible for the offence. Use of the 'failure to prevent' model used in the Bribery Act could be considered which would overcome this problem.
- b. Cases involving serious pollution or health and safety breaches can affect large numbers of people and can be severe. In the UK these would often be regulatory offences with a strict liability regime (i.e. the prosecution does not need to prove criminal intent). Traidcraft's research suggests that these are some of the most common abuses carried out by UK-linked companies in developing countries. There needs to be consideration of extra-territorial application for the most severe breaches and the 'failure to prevent' model could also be considered.
- c. For cases where there is a death, the Corporate Manslaughter Act could be amended to allow for its extra-territorial application. This would need to be accompanied by a review of the liability regime of the Act. It has been recognised that the current regime makes it difficult, even within the UK, to prosecute large companies where senior managers cannot be 'identified' as personally involved in a decision which resulted in the death.

¹² <http://www.traidcraft.co.uk/media.ashx/above-the-law-nov-15-final.pdf>

B) How stakeholder perspectives reach Boards, and are acted upon

Strengthening the employee, customer and wider stakeholder voice

Q7. How can the way in which the interests of employees, customers and wider stakeholders are taken into account at board level in large UK companies be strengthened? Are there any existing examples of good practice that you would like to draw to our attention? Which, if any, of the options (or combination of options) described in the Green Paper would you support? Please explain your reasons.

Q8. Which type of company do you think should be the focus for any steps to strengthen the stakeholder voice? Should there be an employee number or other size threshold?

Q9. How should reform be taken forward? Should a legislative, code-based or voluntary approach be used to drive change? Please explain your reasons, including any evidence on likely costs and benefits.

B) 1. Are Directors interested in hearing wider stakeholder perspectives?

Currently Director's duties do not require directors to act in the interests of different stakeholders. So whilst it is welcome that the Government is consulting on strengthening stakeholder's voice in influencing management decisions, the reality is that directors do not consider acting upon stakeholders' perspectives necessary under the current Director's duties. The following are a few examples of stakeholder concerns which have been brought to a company board's attention, but where action has not been taken in favour of the stakeholder.

a. Local community

The previous section A) 3.b) provided examples where directors were aware of harm to the local community but did not act to deter such brutal harms being inflicted by security providers with whom they maintained a contract.

b. Staff members in an overseas operation

A newly arrived director of a Chinese subsidiary of an international service company discovered that the senior management team of the Chinese company was syphoning off pension contributions of junior staff in the Chinese operations. The new director of the Chinese operations informed their line manager, a director on the board. The upshot was that the board director chose not to act in the long term interests of its staff. It did not want to lose the business that those senior managers were bringing into the company. The executive director acted in the interests of the company maintaining a full order book. It is unclear if this information was ever presented to the non-executives on the board. It is also unclear if the board would have made a different decision.

c. Consumers, customers, licensing authorities

A whistle blower in an international medical products company raised concerns with the legal affairs team about unauthorised distributors coming to their depots to collect products. The legal affairs team had previously been

notified that their products were being sold in countries that they didn't have a licence for. The use of unauthorised distributors is probably the route by which medical products became available for sale in countries where the company has no license. Despite this situation being raised with the executive director responsible for the legal affairs team, the use of unauthorised distributors collecting from the company depots continued. It maybe that the priority to maximise its sales, super cedes other considerations. Again it is unclear if this information was ever presented to the non-executives on the board. It is also unclear if the board would have made a different decision.

d. The examples above highlight that some executive directors are narrowly defining their role, and are not having regard for their wider director's duties.

B) 2. How stakeholder perspectives are gathered, from which sources, and through which communication channels

Within each particular stakeholder grouping there will be divergent views. Directors need to understand the range of views within a stakeholder group to be able to manage relationships well. So directors need to consider how they gather stakeholder perspectives, from what sources of information, and through which communication channels.

B) 3. There are objective sources of information in the public domain about Stakeholder's relationships with companies

In some sectors there is already information in the public domain from authoritative sources about companies' relationships with key stakeholders. These sources of information could act as a proxy for stakeholder perspectives, or supplement stakeholder perspectives being heard in a more dynamic manner at board level.

For example the following sources can provide data when the board is considering stakeholder perspectives, or when the remuneration committee is assessing an executive against a balanced scorecard of performance metrics.

a. Supplier relationships with food retailers. The UK Grocery Code Adjudicator's Annual Supplier Survey¹³ provides supplier perspectives on the UK's largest 10 food retailers' relationships with their suppliers, and in particular whether they are breaching the GSCOP fair purchasing order. Other countries also have regulators which publish information about which retailers have been fined for abusive purchasing practices towards their suppliers in the food sector.

b. Suppliers' perspectives in the garment sector are starting to be more formally surveyed. The International Labour Organisation conducted a survey

¹³ <https://www.gov.uk/government/publications/annual-sector-survey-results-2016>

in 2016 in relation to purchasing practices mainly in the garment sector¹⁴. The Better Buying Initiative¹⁵ aims to provide a rating for the large garment brands and retailers on how they purchase. On 25 February 2017 the Bangladeshi Garment Manufacturers Exporters Association will publish survey results relating to their members' experience of selling to different international brands and retailers⁵.

c. Consumer perspectives can be assessed in the sectors where there is a relevant regulator or an ombudsman. For example the Finance Ombudsman's reports provide a perspective as to whether consumers of large banks and financial companies are being treated fairly¹⁶.

d. Legal judgements of both county and higher courts might indicate a breach of director's duties in relation to high standards of good business conduct, and poor quality relationships with key stakeholders.

e. Environment agency fines may imply a breach of duty to have regard to the environment.

f. Health and Safety Executive judgements and fines might imply a breach of duty to have regard to employees, or a community, and might be an indicator of poor quality relationships with these stakeholders.

g. Employment tribunal outcomes may imply a breach of duty to have regard to employees, and that there are poor quality relationships with employees.

B) 4. Different methods for hearing Supplier perspectives. Traidcraft is particularly concerned about the supplier stakeholder perspective, since it is suppliers which employ workers and purchase from farmers in developing countries. The ability of suppliers to do this well and contribute to the development of their country, is dependent on their relationships with their customers.

The following section considers the method of how information concerning suppliers reaches the customer's directors. Different examples and experiences are shared below to provide insights as to what might be the most effective methods for stakeholder perspectives to reach the board.

¹⁴ http://www.just-style.com/news/survey-seeks-feedback-on-buyer-purchasing-practices_id128819.aspx

¹⁵ <http://www.betterbuying.org/Home/about-us>

¹⁶ Eight financial services groups – Lloyds, Barclays, HSBC, RBS, Nationwide, Santander, Aviva and Direct Line need to pay Group fees to the Finance Ombudsman due to significant ongoing workload of consumer complaints associated with these companies.
<http://www.financial-ombudsman.org.uk/publications/directors-report-2016.pdf>

B) 5. Actions taken by the customer to learn about quality of supplier relationships

a. Commissioning an independent survey which reports into governance structure of a company.

Traidcraft plc exists to benefit workers and farmers in its supply chains. Traidcraft employs staff who are custodians of Traidcraft's supplier partnerships, and these staff report into the management structure. Each year Traidcraft gathers views and produces a social account of how key stakeholders and beneficiaries of Traidcraft view the organisation. This is now reported in Traidcraft's Annual Review of Impact and Performance¹⁷. Surveys and objective information on indicators selected by stakeholders provide an independent perspective to the Traidcraft Foundation¹⁸ of how Traidcraft has impacted upon its key stakeholders. Key indicators monitored not only include the absolute volume of developing world purchases but also the degree of impact that these purchases have. The "filing" of social accounts of different stakeholders' perspectives to Traidcraft Foundation forms a key part of Traidcraft's governance process.

As part of this social accounts process Traidcraft has wanted to check on the quality of its supplier relationships. Traidcraft either undertakes an anonymous survey of suppliers. Or in some years consultants conduct phone interviews with key suppliers, and then provides a report where the individual perspective of suppliers' has been anonymised. This provides useful management information from a stakeholder group which is naturally cautious of criticising customers. The report from the supplier survey, is not only submitted to Traidcraft's Foundation along with other stakeholders but it is also is then publically reported¹⁹.

b. Internal auditors checked a supplier's perspective on an issue

The internal audit function usually reports into a non-executive director. In this manner information can reach the board bypassing the Chief Executive. An internal auditor from a customer proactively travelled to check with a supplier that a major change in the ordering pattern had occurred for legitimate reasons. This appears to be a good practice by a customer concerned about the possibility of bribery occurring, which might not have been reported by line managers.

c. Use of external auditors Customers specify that external auditors are hired to check whether suppliers are meeting minimum labour rights

¹⁷ <http://www.traidcraft.co.uk/media.ashx/annual-review-2015-16.pdf>

¹⁸ Traidcraft foundation is Traidcraft's highest level of oversight and it exists as a safeguard mechanism. The Traidcraft Foundation has the power of veto if either Traidcraft Plc or the sister charity Traidcraft are in danger of not working to contribute to the mission statement of "fighting poverty through trade"

¹⁹ p17 of Annual Review of Impact and Performance 2015-2016
<http://www.traidcraft.co.uk/media.ashx/annual-review-2015-16.pdf>

standards and other standards in their supply chains. External auditors are able to report as to whether a standard has been met, but may not fully reflect all the impacted stakeholders' perspectives.

- i. For “high risk” issues such as child labour, the auditor and customer need to engage with the child and their family to understand their perspectives. The best practice outcome is for the customer to engage with the supplier to remediate the situation. This involves facilitating the child going to school, and replacing the child’s contribution to household’s income. If the auditor, supplier and customer do not respond to the child’s and the family’s perspective there is the risk the child will leave school and return to earning money. In this instance these particularly vulnerable stakeholders have had their perspective heard and their immediate situation addressed. The supplier’s perspective of their relationship with the customer may or may not have been heard. In these “high risk” circumstances a customer may still not act improve their own purchasing practices – so that prices they pay suppliers are sufficient for adult workers in the family to send their children to school.
- ii. Auditors are also able to provide information on issues considered low risk by the company, but are a priority concern for workers at supplier factories, such as the non-payment of social security. In spite the provision of good quality information by auditors, business customers sometimes do not act. This is despite significant numbers of workers impacted, and that the non-payment of social security can be a direct outcome of the customer reducing prices paid to their suppliers.

d. Supplier conferences

Many businesses run supplier conferences that the director in charge of supply chain attends, and these include an open Q&A session where theoretically suppliers can raise questions. However suppliers consider these to be ineffective forums for feeding back to customers about problems the customers create. Suppliers are in a weak position and do not want to offend by raising issues in an open forum.

B) 6. Experience of Suppliers raising concerns with customers on their own initiative Suppliers are in a vulnerable position relative to their retail, brand and manufacturing customers. They are vitally dependent on these businesses for their sales. The following are some experiences that overseas suppliers have had in raising concerns with their customers. These provide insights as to possible effective routes for stakeholder perspective to reach the board.

- a. Identifying where to submit complaints regarding “high risk issue” into a customer Garment suppliers have to wait for the customers’ quality assurance (QA) staff to approve a production sample, before they can start their production run. This puts individual quality controllers in a position of significant power, and some ask for gifts from suppliers. To address this

problem suppliers interviewed have submitted:

- i. complaints to the Human Resources department of a customer about a particular QA staff member requesting bribes. This has proved to be effective, presumably because the supplier has strong relationships with staff in the customer, to not be dependent on its relationship with the QA.
- ii. a complaint to the ethics hotline of a business customer about the systemic issue and the need for the customer to educate their QAs. They did not give the exact name of the QA which triggered their complaint to the ethics hotline for fear of jeopardising future approvals by that QA.

b. Experiences of stakeholders raising issues which are not considered high risk by the customer

Instances of Bribery are high risk for companies because there are laws in place which can result in companies or individuals facing criminal prosecution.

- i. A priority concern for suppliers is their payment terms, and the notice periods they are given for orders. When business customers change their payment terms to 120 days, this stretches suppliers who have already paid for fabric, accessories and labour involved in producing the products. Suppliers want access to board level executives at the customer to be able to discuss informally and then amend business terms formally. However usually only the large and strategic suppliers get access to the relevant directors in their customers.
- ii. A priority concern for workers of a supplier is to be paid correctly and in full. In instances where suppliers discretely change the location of their factory, but do not pay workers at the old location their last month's salary, nor severance pay - the workers can be left destitute. Particularly in countries where there is weak law enforcement. The business customer may be unaware of the change in location, as they continue to receive product. When an overseas trade union, approaches the customer's social compliance team to remedy the situation, for the workers who made their products previously - there has not been a good track record of resolving the situation and providing the correct pay to workers.

B) 7. Options for which method stakeholder perspectives can reach company directors.

Examples from the experience of suppliers sharing their perspective with their customers provide some key considerations for thinking about how wider stakeholder perspectives can be heard.

- a. The following considerations about the best *route* for hearing information need to be caveated by reflecting on whether directors are actually interested? If the directors are not interested, then it can be a waste

of stakeholders' time to engage in tokenistic consultations.

- b. What is the best route for different perspectives to be fed to the board? Is it via the executive management structure, or to a non-executive, or via worker representatives on boards, or other mechanisms?
- c. Stakeholder perspectives reaching the board via Executive communication channels. As has been highlighted in the examples above relying on priority concerns of stakeholders to be raised at company boards through company management reporting systems is unlikely to be effective. Management reporting is dominated by their perspectives of their relationships with stakeholders.
- d. Stakeholder perspectives reaching the board via non-executives This route for information to reach company boards might be more fruitful.
- i. The internal audit function usually reports into a non-executive director. In this manner information can reach the board bypassing the Chief Executive. The internal audit function of a company will have its resources and priorities set for it by the board of a company. Usually the internal audit function of a company is tasked with checking business performance in highly regulated areas, to avert the company being prosecuted. Since there is no enforcement of director's duties, it is not clear that the internal audit function will be effectively tasked to gather stakeholder perspectives regarding the company for the board.
- ii. A separate "arm's length" part of the company which reports into a non-executive director, (similar to internal auditors) could be tasked with gathering stakeholder perspectives accurately to inform non-executives. This communication channel would enable stakeholder perspectives which might be divergent from the management view to reach the board. This mechanism for gathering stakeholder perspectives may not be as effective as having stakeholder perspectives directly representing their views at an advisory group meeting where non-executive directors are present.
- iii. External consultants can be commissioned to gather and then provide stakeholder perspectives to the board. Traidcraft's social accounts process gathers the perspectives of stakeholders and feed these into the most senior part of Traidcraft's governance structure, which is above the board. If this mechanism is to be copied the consultants should produce an independent report.
- iv. Advisory committees to the board could be established to gather stakeholder perspectives which then report into a non-executive director. In this situation consideration needs to be given to the terms of reference of the committee. There also needs to be clarity on the responsiveness expected of the company, how representatives will be selected and supported (and perhaps safeguarded) in fulfilling their

function. The Body Shop used to convene ad-hoc advisory meetings to hear stakeholders' perspectives when a new business strategy was being developed.

- v. Suppliers interviewed would very much like their customers to listen to their perspective and improve their sourcing practices. However based on their experience of how their customers are passing on more and more risks onto the supplier, they questioned whether supplier perspective would actually be listened to or acted upon.

B) 8. Worker representatives and other stakeholder perspectives at board level

a. Worker perspective

Traidcraft has had an elected staff representative on its board for more than 15 years. This has been considered invaluable by the previous and current chair of Traidcraft's board. It has enabled the perspectives of staff to be presented. On balance Traidcraft's preferred option is for the staff representative not to be able to vote, to avoid perceived conflicts of interest (between representing the majority staff view, versus acting in interests of the company). The staff representative participates fully in board discussions. They have only been required to leave board meetings along with Finance Executive, Chief Executive and other staff when there is a need to safeguard confidentiality.

The staff representatives over the years have been able to share some perspectives of customers, suppliers and pension-fund members at board meetings. Other stakeholders' perspectives have been shared informally. The extent to which different stakeholders' views can be shared is dependent on which stakeholders the staff representatives have had contact with.

German company boards also have worker representatives. Where these worker representatives have been members of international unions they have been able to raise the perspective of workers working in their supply chains, when there has been cause for concern. This has led to engagement of the purchasing company with situations occurring at supplier sites.

b. Shareholder and Customer views at board level

Traidcraft currently has a retail customer on its board. This director's contribution is significant. They are able to provide particularly pertinent insights. Non-executive directors with general business or development backgrounds do not have such relevant experience.

Traidcraft has had a specific "shareholder" representative at the board, predominantly to represent the perspectives of individuals who had bought shares in Traidcraft. This individual was voted onto the board by other Traidcraft shareholders.

B) 9. Recommendations for reforms to improve how stakeholder perspectives are gathered and then acted upon.

a) Consultation with suppliers indicated that they would welcome sharing their perspectives. However, without a much more explicit requirement on directors to maintain good quality supplier relationships - suppliers are nervous that whilst they might find the courage to share their perspectives – they were unsure that companies would act.

Directors duties should be revised as proposed in the previous section A) 5a). This creates an obligation on directors not only to “have regard to” wider stakeholders but also to act upon the information received. Unless this reform is undertaken it is not clear whether improved quality of information on the stakeholders’ perspectives, will be acted upon by directors.

b) Inclusion of staff representatives on boards should be mandated for all companies with more than 250 staff. Staff representatives have valuable perspectives to share, which are important for Non-Executive Directors to hear.

c) Stakeholders’ perspectives on their relationship with company would be best fed into non-executive directors. Traidcraft would recommend its social accounts process, which provides the most senior part of Traidcraft’s governance structure with an “account” of Traidcraft’s impact upon stakeholders.

d) Traidcraft welcomes the fact that since Jan 2017 all listed companies and some large companies with more than 500 staff will be required to disclose risks in relation to their key stakeholders, human rights, bribery and diversity. This report will be written or commissioned by management. Unless objective information has to be reported, there is a danger that stakeholders’ perspectives will be overlooked.

Whilst gathering information about the company’s relationships with its stakeholders is useful - it is unclear whether this increase in information will lead to a change in the actions of a company. In the current formulation of director’s duties when there is a conflict between different stakeholders’ interests, the members’ (shareholders’) interests have priority.

e) Advisory groups, comprising of different stakeholder interests, could report into non-executives on the board.

C) Executive pay has two problems – what performance is assessed, and how pay is set

Executive pay

Q1. Do shareholders need stronger powers to improve their ability to hold companies to account on executive pay and performance? If so, which of the options mentioned in the Green Paper would you support? Are there other options that should be considered?

Q3. Do steps need to be taken to improve the effectiveness of remuneration committees, and their advisers, in particular to encourage them to engage more effectively with shareholder and employee views before developing pay policies? Do you support any of the options set out in the Green Paper? Are there any other options you want to suggest?

Q4. Should a new pay ratio reporting requirement be introduced? If so, what form of reporting would be most useful? How can misleading interpretations and inappropriate comparisons (for example, between companies in different sectors) be avoided? Would other measures be more effective? Please give reasons for your answer.

Q6. How could long-term incentive plans be better aligned with the long-term interests of quoted companies and shareholders? Should holding periods be increased from a minimum of three to a minimum of five years for share options awarded to executives?

Please give reasons for your answers.

C) 1. What performance is rewarded by Executive pay (Q1 -6)

Executive pay should be set in a manner that rewards directors for ensuring full compliance with the law and for complying with director's duties. The inclusion of shares in Long Term Incentive Plans (LTIP) is done to align the executives' interests with shareholders. Currently there is no obvious component of executive pay which is aligned to the performance of the director's duties relating to good relationships with suppliers, customers, community, and the environment, or long term considerations, or standards of good business conduct.

Traidcraft suggests all directors have the same generic set of headings for performance reflecting the different elements of director's duties. This balanced scorecard would determine payments made as a bonus.

If remuneration included a broader spectrum of criteria including environmental impact, impact on shareholder value, impact on supplier value, impact on local communities etc - this could stimulate a very useful discussion on the real (moral) value of running a business, and hopefully lead to businesses making a better contribution to society and the economy.

C) 2. Objective sources for assessing performance of a company in relation to how it conducts its relationships with key stakeholders are available. The assessment of director's performance should be undertaken objectively. The perspectives of stakeholders should be used to assess performance, not just information provided internally by the company on the quality of relationships. (See footnote ¹⁰ where it is clear that the management of a mining company's

perspective on community relations, is at odds with the perspective of people who had been severely harmed.)

A list of objective, independent sources which could be used for assessing an executive director's performance against their duties is listed previously in Section B) 3.

C) 3. Do Long Term Incentive Plans continue to reward ex-executives for breaching the law?

There is a need to avoid rewarding executives for poor performance. Sometimes poor performance, including breaches of the law come to light after executives are no longer at the company. It would not be appropriate for ex-executives to continue to receive their LTIP payments in full if it later comes to light that the company breached the law whilst they were an executive. Otherwise executives can be rewarded for actions which yield short term benefit, but are actually illegal.

The earlier Section A) 3.a) highlights that the Grocery Code Adjudicator's investigation into Tesco's appears to indicate that the directors did not have regard for their supplier relationships. The investigation looked at Tesco's relationships with suppliers between 25 June 2013 and 5 February 2015. The GCA found that Tesco was guilty of breaching the GSCOP fair purchasing order. Phil Clarke was Tesco's Chief Executive from 2011 to 1st Sept 2014. When he left he was entitled to salary and share schemes of more than £7m. His Long Term Incentive Plan (LTIP) included £1.1m in deferred bonus shares which could be exercised²⁰.

Mr Clarke was a Chief Executive of Tesco during the majority of the period of the GCA's investigation. It does not seem appropriate that an ex-Chief Executive is able to receive ongoing payments if it subsequently comes to light that their company did not comply with the law whilst they were a Chief Executive. Tesco has the possibility to recover the termination payment of £1,217,000 which was made on 6 February 2015 if it is determined there was gross misconduct. It is not transparent whether the termination payment has been recovered, and or whether LTIP was paid out in full.

The government should consider providing a mechanism whereby pay-outs from Long Term Investment Plans are reduced to executives if it comes to light that the company breached the law during an executive's tenure. Where

²⁰ p56 Tesco Annual Report and Financial Statements 2015 -
https://www.tescopl.com/files/pdf/reports/ar15/download_annual_report.pdf

Leaving arrangements for Philip Clarke

"Philip Clarke may exercise vested PSP awards granted in 2008 (325,749 shares) and 2009 (188,521 shares) until 19 January 2016. Philip Clarke may exercise vested discretionary share option awards granted in 2006 (404,896 shares), 2007 (298,844 shares), 2008 (353,114 shares) and 2009 (467,848 shares) until 19 January 2016, in accordance with the terms of the plan rules."

there are instances where ex-executives directly breached the law whilst working at the company, then LTIP payments should be terminated.

This would also incentivise company executives to pay more attention to legal compliance, and ensuring the company operated with good quality, effective management systems which would also sustain compliant operations by the company.

C) 4. International relations consideration: Fairness of remuneration internationally.

a. All workers – directors through to the lowest paid workers need to be paid a fair wage for the work that they do. This income needs to be sufficient to meet their basic necessities and ideally provide for some discretionary spend. We are aware as a fair trade organisation both purchasing from developing countries and also influencing UK companies' supply chain policies that many of the workers and farmers involved in supplying the UK are not paid a 'living wage'²¹ for the work that they do. In many cases the work involved in transforming raw material into the products is undertaken by the workers in developing countries and then 'resold' in the UK. Pay scales have become severely out of balance globally. In developing countries (where free medical, education, pension provision are frequently not available) workers undertaking the bulk of the transformative work are often paid less than a living wage, whilst senior retail executives who re-sell products in the UK are paid far in excess of their needs²². Traidcraft would be interested in seeing not only greater fairness of incomes within the UK, but also globally.

b. As a fair trade importer we aim to purchase products from small enterprises and farms that pay workers a living wage. There is currently a considerable debate about how to define a living wage. However the Ethical Trading Initiative is urging its member companies not to "allow the challenge of how to calculate a living wage to distract companies from raising wages. In many countries the minimum wage falls so far below any living wage estimations that even significant increases in pay are unlikely to exceed a living wage." The table below highlights how living wages relate to minimum wages in key countries supplying the UK's clothing brands and retailers.

²¹ What is a 'living wage'? The ETI Base Code says that 'wages should always be enough to meet basic needs and to provide some discretionary income'. www.ethicaltrade.org/in-action/issues/living%20wage

²² In 2009/2010 year Sir Terry Leahy, chief executive of Tesco, earned more than £5.2m in salary and bonuses. Guardian Wednesday 2 June 2010; Telegraph

Table: 2008 Minimum and Living wage estimates in the key countries supplying UK clothing retailers and brands²³.

Country	Is a minimum wage a Living Wage (LW)? Minimum wage as % LW	Estimated Living Wage/ month
Bangladesh	No 36%	£35
Cambodia	No 83%	£30
China (Varies by region, municipality & foreign or state-owned ownership)	No 90%	£66
India	No 59%	£52
Turkey	No 28%	£984
Vietnam – varies according to state-owned or foreign owned companies	No 33% or 61%	£45

Workers in developing countries make the products which are re-sold by UK retailers. But they do not earn sufficient to live on. If directors of UK retailers were paid a £1million pounds per year²⁴ in 2008, this equates to more than £83,000 per month. This is 85 times more than a living wage in Turkey, and 2,700 times more than the living wage in Cambodia. Whilst the costs of living are different between Cambodia, Turkey and the UK it is clear that individuals are earning vastly different salaries whilst all contributing to making and selling the same product. A more important consideration is that excessive salaries are paid to some individuals whilst other workers in the same supply chain are unable to meet their basic needs. If trade is going to contribute to fairer societies there should also be a consideration of fairness across salaries in international supply chains.

C) 5. Policy Consideration - Fairness within a country and a company

a. Executives are employees. Traidcraft is in support of 'equal pay for equal worth' however we would wish to see greater equality in how people were paid, for approximately a similar number of hours of work. It is debatable whether directors need to be paid significantly more than lowest paid members of staff living in the same country or area. In 2011 Traidcraft was concerned that inflation in Chief Executive's pay was ~7%. This was a

²³ Traidcraft 2008 "Material Concerns: How responsible sourcing can deliver the goods for business and workers in the garment industry" <http://www.traidcraft.co.uk/media/e6645fed-648d-4e62-bc20-76bc30700dc7>

²⁴ £1,000,000 per year was the average pay FTSE 100 CEOs were receiving in 1998. Executive pay has risen since 1998 to £4.3m being the average CEO pay in 2015. Data from Manifest Pay & Performance survey 2015, cited in the Nov 2016 BEIS Corporate Governance Green Paper

significantly higher percentage increase in pay, than the pay freezes, minimal increases, or drop in pay which was given to the majority of employees in the UK at that time. We note that Chief Executive pay has risen to a multiple of 128 above the average pay of staff in the same company. However the needs of a chief executive and their family are unlikely to be 128 times greater than another staff member. All employees make a valuable contribution to the success of a company, and so all should share in the benefits when the company has a successful year.

b. Traidcraft UK has a policy that the highest paid member of staff should not be paid more than six times the full time equivalent of the lowest paid member of staff in the UK. This is a position that has evolved after the business started more than 30 years ago with a 1:1 salary ratio amongst the staff. (We are aware that similar fair trade social enterprises in other European countries have lowest to highest salary ratios of 1: ~1.2.)

We consider that the published ratio should not be between the highest and average salary package, since this statistic purposefully hides the situation of the lowest paid member of staff. In a context where the government is keen to dissuade the use of modern day slaves, the ratio should be between lowest paid and highest paid employees (including executives).

To stop the unintended consequence of businesses outsourcing jobs to service providers, the government can require the pay of workers undertaking outsourced functions, which are needed for the ongoing smooth operations of the company, to be included when calculating the ratio. Specifically cleaners, reception staff and security guards whose functions are frequently outsourced, should be included when a business publishes its salary ratio between highest and lowest. Good practice businesses have already engaged their service providers of these outsourced jobs to pay a living wage²⁵. Including workers who contribute on a daily basis to the smooth operation of a business within the ratio will avoid the unintended consequence of businesses outsourcing their lowest paid jobs. Disclosure of a lowest to highest ratio would make it in the self-interest of a chief executive to raise pay at the lowest levels.

c. Policy consideration - Threshold level for excessive pay

Traidcraft would like to see executives' salaries set within an acceptable multiple above the lowest paid member of staff. However in sectors where the lowest salary is already high, the UK government should establish a principle that salaries above a particular threshold need to be questioned. Salaries of

²⁵ More than 1,000 Living Wage Employers in the UK make the payment of a living wage a requirement when they are selecting service providers who deliver services on-site. "Living Wage Employers: evidence of UK Business Cases" By Andrea B. Coulson and James Bonner on behalf of the University of Strathclyde, in partnership with the Living Wage Foundation 2014/15
http://www.livingwage.org.uk/sites/default/files/BAR_LivingWageReport%20cropped%201%2001.pdf

more than £1million are taking significant resources out of the company, and non executive directors should be questioning whether those assets would be better spent differently.

C) 6. Problems of excessive pay

We have the following wider concerns about high levels of executive pay. That it:

- i. diverts money away from core business activities;
- ii. undermines feeling of cohesion within a company;
- iii. undermines social cohesion within a country when there is significant disparity in pay²⁶;
- iv. can be a factor in stimulating demonstrations of discontent;
- v. can be a contributory factor to migration when there are significant disparities in pay internationally.

C) 7. Components of executive pay

- a. Currently executives are paid with a salary, share schemes and bonuses.
- b. The payment of salary is a fair way to pay people for a day's work. Bonuses are appropriate for exceptional performance. However it could not be said for all of the executives getting bonuses that their performance has been exceptional.
- c. Keeping discretionary and conditional pay as percentage of the basic salary keeps these two elements in proportion. Directors will still get larger bonuses than other staff, because payments based on small percentage of a large director's salary will result in large discretionary payments.
- d. Every time a new performance metric, including new types of share options, is added to a director's set of objectives, there is the potential that this translates to an increase in pay. Traidcraft considers that there is a need to set out clearly what the maximum envelop of remuneration should be.

C) 8. How Executive pay is set is problematic.

- a. As acknowledged by BEIS' Green paper, executive pay is currently set and approved in a manner influenced by vested interests. Consultants are hired by directors whose pay they are advising on. Non-executives approve the pay of their peers, which then indirectly influences the pay they may receive in their executive roles.
- b. It is appropriate that the remuneration committee is composed of a subset of the full board, and should be chaired by a non-executive director. The remuneration committee is given a mandate by the full board to propose suitable remuneration packages, which is then usually approved by the chair of the board. There is a need to change the culture of non-executives

²⁶ "The Spirit Level" (2009) by Richard Wilkinson and Kate Pickett studied ~23 countries and found that health and social indicators were worse in the most income-unequal countries.

approving disproportionate pay increases for the executives which may indirectly influences the pay they may receive in their executive roles. This perceived or actual conflict of interest where peer pay is approved around the table needs to addressed.

- c. The priority should be given to getting a full board with diverse set of backgrounds to be able to fulfil director's duties. A diverse board, with wide variety of skills, backgrounds and which includes worker representatives would then be more critical in their assessment of how much should be spent on executive remuneration as part of a discussion of the most appropriate use of the company's resources. Non executives could give a steer on suitable maximum levels of pay, and weightings to be given to performance assessments.
- d. Long term incentive plans are opaque, and rewards based on share-price on a particular date can drive decisions to advantage individual executives, rather than the company, or its shareholders or other stakeholders. Lessons from the collapse of Enron indicate that the method of giving share options at a reduced price need to be carefully thought through to ensure that directors are not incentivised to stimulate unstable share prices. The price at which share options can be exercised needs to include a criterion for assessing the stability of a particular valuation.
- e. As acknowledged in the Green Paper - Advisory votes are problematic since they potentially put the company in breach of an employment contract with a director, if a pay package has already been approved by the board, but is then rejected by shareholders. The shareholders could instead vote on which non-executive director chairs the remuneration committee.
- f. Given the problematic nature of the way in which executive pay is set, there is a role for the government to intervene, to stop pay spiralling out of control. We suggest that an approval process should be triggered in advance of either of two events occurring.
- i. When executives' pay exceeds a certain ratio above the lowest paid worker's pay. (Suggested ratio could be 50.)
- ii. When a proposed maximum threshold of pay might be surpassed. (Threshold of £1 million is suggested to reduce absolute levels of remuneration.)
- Possible approval processes which could change the culture around pay could include:
- a televised public vote where more than 80% of the shareholders need to positively endorse pay above the threshold or above a ratio.
 - a public interview with chair of the remuneration committee by an external stakeholder panel on why pay above a threshold or a ratio has been proposed.

- other activities involving external stakeholders which will change the culture so that executives are less likely to pursue pay above a threshold.

C) 9. Recommendations in relation to Executive pay

C) 10. *Pay should align with performance against wider Director's duties.*

Before there is a discussion of what executives are paid, consideration needs to be given to what performance by executives is rewarded. Executives' bonus should be based on a balanced scorecard of performance measures which correlate to wider Director's duties.

C) 11. *Payments from Long Term Incentive Plans (LTIP) should be terminated or reduced if an executive director breached their duties or the company broke the law during their tenure.*

C) 12. *Government should promote the following components of Executive pay*

- a. The government should set an expectation that maximum annual envelop of remuneration for executives should be below a threshold to avoid LTIP getting out of hand. We suggest £1million/year.
- b. The salary component should comprise the majority of the total remuneration package.
- c. Bonuses and share options should be paid for *exceptional* performance and be a modest percentage of the base salary.
- d. The executives' salaries should be on a pay scale linked to other employees in the company.

C) 13. *Government intervention to shape Executive pay* We are aware that our suggestions for what comprise Executive pay are distant from some of the current remuneration structures. However it is in society's and the economy's interest to rein back excessive executive pay. The UK government has a role to play in setting expectations and putting in place thresholds which trigger disclosure and approval processes.

a. *Large companies should disclose maximum to minimum salary ratio* (taking into account lowest paid workers, not just employees, who contribute to the smooth daily operation of the business' activities). We consider ratio of maximum to minimum to be better ratio to disclose, rather than maximum to average pay.

b. *An approval process should be triggered in advance of either of two events occurring.*

- i. *When executives' pay exceeds a certain ratio above the lowest paid worker's pay. (Suggested ratio could be 50.)*
- ii. *When a proposed maximum threshold of pay might be surpassed. (Threshold of £1million is suggested to reduce absolute levels of remuneration)*

Suggestions for approvals processes which might change the culture are made above in section C) 8.f.

C) 14. *Shareholders should influence prior to a remuneration proposal*

The shareholders could vote on which non-executive director chairs the remuneration committee. This might be more effective than advisory votes after a remuneration package has already been developed.

D) Corporate Governance in large privately held businesses

Corporate governance in large, privately-held businesses

Q10. What is your view of the case for strengthening the corporate governance framework for the UK's largest, privately-held businesses? What do you see as the benefits for doing so? What are the risks to be considered? Are there any existing examples of good practice in privately-held businesses that you would like to draw to our attention?

Q11. If you think that the corporate governance framework should be strengthened for the largest privately-held businesses, which businesses should be in scope? Where should any size threshold be set?

Q12. If you think that strengthening is needed how should this be achieved? Should legislation be used or would a voluntary approach be preferable? How could compliance be monitored?

Q13. Should non-financial reporting requirements in the future be applied on the basis of a size threshold rather than based on the legal form of a business?

D) 1. It is difficult to generalise about private companies, because their performance is significantly influenced by the different characteristics of their owners.

D) 2. Two out of the 24 businesses researched by Traidcraft which are alleged to have caused serious harm were private. The scale of harm caused by private companies can be just as large as listed companies.

D) 3. In addition to the two companies identified in our research, Traidcraft considers that the owners of BHS managed its assets poorly. The demise of BHS has not only had consequences for BHS pensioners but also suppliers. Traidcraft is aware of garment suppliers in Bangladesh who were owed money by BHS. One supplier was owed more than £500,000 pounds. It took more than two weeks to settle and this supplier was only paid 82p for every £1 owed to them. Other suppliers waited more than a month to be paid and were paid approximately 50p per £1 owed to them. This puts garment suppliers under serious financial squeeze as approximately 75% of what a garment manufacturer earns is spent on raw materials. There was very little information in the public domain about how BHS assets had been managed, and what the assets had dwindled to, when suppliers started to chase delayed payments.

D) 4. The tools for shaping the priorities of the directors are very limited. Particularly when both the owner and the Chief Executive are sometimes the same.

D) 5. Large private companies often choose not to adopt good practice corporate governance codes, which have been established for many years. By purposefully operating to lower Corporate Governance standards they are effectively undermining good practice by their competitors who may be public listed companies. To create a level playing field it is unlikely that further

exhortations by Government to Venture-Capital owned companies, and other privately owned companies to adopt voluntary codes will be successful.

D) 6. Recommendations to improve Corporate Governance of Private Companies

D) 7. To improve actions of directors in private companies it is necessary to change director's duties in the Companies Act to improve how companies treat their stakeholders as proposed above in A) 5a) Changing director's duties in the companies act applies to both to private and listed companies operating in the UK.

D) 8. The right of action to enforce director's duties in a private company, cannot rest solely with the owner. Either BEIS or a new regulator should be established that is able to sanction directors, and disqualify directors for breach of their duties, gross misconduct and if their companies commit crimes. Please see section A) 4 and A) 5 b) above which discuss and present recommendations on directors' disqualification.

D) 9. Given the scale of private companies' operations can be as significant as a listed company, Traidcraft agrees non-financial reporting requirements should to be applied on the basis of size, not on legal form.

D) 10. Thresholds for private company reporting could be based on the number of employees, global turnover and if a company operates internationally. Companies which operate internationally need to provide stakeholders that are further away with relevant financial and non-financial information, including information on likely impacts of their business operations, and what standards the company intends to abide by.